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IN THE

Supreme Court of the United States

GREEN TREE FINANCIAL CORP.
A/K/A GREEN TREE ACCEPTANCE CORP.
A/K/A GREEN TREE FINANCIAL SERVICES CORP.
N/K/A CONSECO FINANCE CORP.,

Petitioner,

v.

LYNN W. BAZZLE AND BURT A. BAZZLE,
IN A REPRESENTATIVE CAPACITY ON BEHALF OF A CLASS
AND FOR ALL OTHERS SIMILARLY SITUATED,
DANIEL B. LACKEY, GEORGE BUGGS, AND FLORINE BUGGS,
IN A REPRESENTATIVE CAPACITY ON BEHALF OF A CLASS
AND FOR ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Writ of Certiorari to the South Carolina Supreme Court

BRIEF OF *AMICUS CURIAE* DIRECTV, INC. IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* prohibits class-action procedures from being superimposed onto an arbitration agreement that does not provide for class action arbitration.

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INTEREST OF THE *AMICUS*[*]

Amicus DIRECTV, Inc., is a California corporation that provides digital satellite television services nationwide. A network of independent retailers sell DIRECTV-compatible reception equipment and promote DIRECTV's services to individuals and businesses who then contract with DIRECTV. Each of these retailers has a Sales Agency Agreement with DIRECTV outlining the rights and responsibilities of both parties to the contract. That Agreement includes an arbitration clause that requires the parties to arbitrate according to the procedures of the Federal Arbitration Act ("FAA"), which do not provide for classwide arbitration.

Some of the independent retailers, however, are seeking to arbitrate their claims against DIRECTV on a classwide basis. And, like the court below, state courts in California and Oklahoma have invoked a public policy favoring class actions to subject DIRECTV to potential classwide arbitration even though DIRECTV never agreed to such a procedure. By thus invoking state public policy to override the parties' contractual freedom to arbitrate according to the terms of their agreement, these courts (like the court below in this case) have undermined the letter and spirit of the FAA. Accordingly, DIRECTV supports reversal of the South Carolina Supreme Court's decision in this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

The FAA requires both federal and state courts to enforce arbitration agreements according to their terms. Where parties have agreed that their arbitration will be governed by the FAA, which does not provide for class actions, courts are not free to override that agreement by invoking a state public policy favoring

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[*] Pursuant to this Court's Rule 37.6, *amicus* states that no counsel for any party authored this brief in whole or in part, and that no person or entity other than *amicus*, its counsel, or its insurer made a monetary contribution to the preparation or submission of this brief. The parties have consented to the filing of this brief, and letters evidencing such consent have been filed with the Clerk of this Court, pursuant to S. Ct. R. 37.3.

class actions. A state policy invalidating arbitration agreements unless they authorize class actions is not a state policy of general applicability, but a policy specifically directed at arbitration, and hence preempted by the FAA.

This straightforward application of FAA preemption is only underscored by the due process implications of classwide arbitration. Class actions are an exception to the general rule that parties represent themselves in a legal dispute, and that exception has been upheld in the courtroom context only in light of procedural rules that carefully limit the use of the class action mechanism. Those procedural rules are inapplicable in the arbitration context, thereby raising serious due process concerns where the parties have not agreed to proceed in this manner. Nor is it feasible to address these concerns through a hybrid court-arbitration procedure, which effectively saddles parties with the *worst* of both worlds: the complexity and delay of the courtroom without the corresponding procedural protections and appellate rights. DIRECTV's experiences with such hybrid procedures have been decidedly negative, and have deprived DIRECTV of the benefit of its federally protected arbitration agreements.

ARGUMENT

I. THE FAA DOES NOT ALLOW COURTS TO INVOKE A PUBLIC POLICY FAVORING CLASS ACTIONS TO OVERRIDE THE EXPRESS TERMS OF AN ARBITRATION AGREEMENT.

As this Court has often noted, the FAA was enacted "to revers[e] centuries of judicial hostility to arbitration agreements by plac[ing] arbitration agreements upon the same footing as other contracts." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987) (internal quotations and citations

omitted).[1] Accordingly, the Act established a "federal policy favoring arbitration," *Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983), that requires courts to enforce private arbitration agreements "according to their terms," *Volt Info. Sciences, Inc. v. Board of Trs. of the Leland Stanford Jr. Univ.*, 489 U.S. 468, 476 (1989); *see also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) ("[C]ourts are bound to interpret contracts in accordance with the expressed intentions of the parties."). Parties are thus free to agree to arbitral procedures as formal or informal as they wish, and the FAA requires both federal and state courts to respect and enforce the parties' agreement. *See, e.g., Volt*, 489 U.S. at 479 ("[P]arties are generally free to structure their arbitration agreements as they see fit," and thus may "specify by contract the rules under which that arbitration will be conducted."); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 709 (7th Cir. 1994) ("[S]hort of authorizing trial by battle or ordeal or, more doubtfully, by a panel of three monkeys, parties can stipulate to whatever procedures they want to govern the arbitration of their disputes.") (Posner, J.).

Like South Carolina, however, California has flouted this federal policy. Recent California decisions indicate a judicial unwillingness to enforce arbitration agreements to the extent they conflict with California's public policy favoring class actions. This trend began with the California Supreme Court's decision in *Keating v. Superior Ct.*, 31 Cal. 3d 584, 623 (1982), *rev'd on*

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[1] *See also Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-220 (1985) ("[The] purpose [of the FAA] was to place an arbitration agreement upon the same footing as other contracts, where it belongs, and to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate.") (internal quotations and citations omitted); *Southland Corp. v. Keating*, 465 U.S. 1, 13 (1984) ("[T]he purpose of the act was to assure those who desired arbitration and whose contracts related to interstate commerce that their expectations would not be undermined by federal judges, or . . . by state courts or legislatures.") (internal quotation omitted).

other grounds sub nom. Southland Corp. v. Keating, 465 U.S. 1 (1984), which held that state law authorized classwide arbitration but did not address "the question whether superimposing class action procedures on a contract arbitration was contrary to the [FAA]," *Southland*, 465 U.S. at 8-9. The California Court of Appeal did address that issue in *Blue Cross of Cal. v. Superior Ct.*, 67 Cal. App. 4th 42 (2d Dist. 1998), and held that "when the arbitration agreement between the parties is *silent* as to classwide arbitration and state law specifically authorizes it . . ., an order compelling classwide arbitration neither contradicts the contractual terms nor contravenes the policy behind the [FAA]." *Id.* at 60 (emphasis added). According to *Blue Cross*, a state policy requiring classwide arbitration in the absence of an agreement to that effect does not violate the FAA, because such a policy does not "divert a case from arbitration to court," but simply "seeks only to make more efficient the process of arbitrating." *Id.* at 59 (internal quotation omitted).

Subsequent California decisions have relied on *Blue Cross* to impose a public policy favoring classwide arbitration *even where the express terms of the parties' arbitration agreement do not permit classwide treatment*. One such decision is *Garcia v. DIRECTV, Inc.*, No. B158570 (Cal. Ct. App. Dec. 11, 2002), a case brought against *amicus* DIRECTV by several retailers. The agreement between DIRECTV and those retailers not only requires arbitration, but specifies that "[t]his section and any arbitration conducted hereunder shall be *governed by* the United States Arbitration Act," thereby evincing the parties' intent to conduct their arbitration under the FAA's, not California's, procedural rules. *See, e.g., Volt*, 489 U.S. at 470, 479 (interpreting this "governed by" language to refer to the procedural rules applicable to the arbitration). As a matter of federal law, however, the FAA does not permit classwide arbitration unless the parties have expressly agreed to such proceedings. *See e.g., Dominium Austin Partners, L.L.C. v. Emerson*, 248 F.3d 720, 728-29 (8th Cir. 2001); *Iowa Grain Co. v. Brown*, 171 F.3d 504, 510 (7th Cir. 1999); *Champ v. Siegel Trading Co., Inc.*, 55 F.3d 269, 276-77 (7th Cir. 1995).[2] Thus, the *Garcia* court overrode the parties' agreement by insisting that the retailers suing DIRECTV must be allowed to pursue a classwide arbitration. That decision is particularly incongruous in the context of the DIRECTV Agreement, which involves sophisticated commercial parties (DIRECTV and its retailers) on both sides, and thus does not implicate the concern with protecting allegedly aggrieved consumers that underlies California's policy favoring class actions in the first place. *See, e.g., Keating*, 31 Cal. 3d at 609.

Indeed, California courts have refused to enforce arbitration agreements that *specifically preclude* classwide arbitration. In *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1101 (4th Dist. 2002), the court of appeal stated that an express class-action waiver provision in an arbitration agreement is unenforceable because it violates California's public policy favoring class actions. According to *Szetela*, such a provision "contradicts the California Legislature's stated policy of discouraging unfair and unlawful business practices, and of creating a mechanism for a representative to seek relief on behalf of the general public as a private attorney general." *Id.* Under *Szetela*, parties to a contract in California *cannot* bargain to preclude classwide arbitration, despite the bargaining freedom protected by the FAA. *Id.; see also Ting v.*

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[2] Similarly, most federal courts have held as a matter of federal law that the FAA does not allow the consolidation of multiple arbitration proceedings absent an express agreement of the parties. *See, e.g., Government of the United Kingdom v. Boeing Co.*, 998 F.2d 68, 74 (2d Cir. 1993); *American Centennial Ins. Co. v. National Cas. Co.*, 951 F.2d 107, 108 (6th Cir. 1991); *Baesler v. Continental Grain Co.*, 900 F.2d 1193, 1195 (8th Cir. 1990); *Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp.*, 873 F.2d 281, 282 (11th Cir. 1989); *Del E. Webb Constr. v. Richardson Hosp. Auth.*, 823 F.2d 145, 150 (5th Cir. 1987); *Weyerhaeuser Co. v. Western Seas Shipping Co.*, 743 F.2d 635, 637 (9th Cir. 1984); *but see New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1, 5 (1st Cir. 1988).

AT&T, ___ F.3d ___, 2003 WL 292296, at *19-22 (9th Cir. Feb. 11, 2003); *Mandel v. Household Bank (Nevada) Nat'l Ass'n*, 105 Cal. App. 4th 75 (4th Dist. 2003).

The analysis of these courts is based on the faulty premise that state courts are free to rewrite arbitration agreements as long as they invoke a doctrine of general applicability, like unconscionability. *See, e.g., Blue Cross*, 67 Cal. App. 4th at 50-51; *Szetela*, 97 Cal. App. 4th at 1099-1100; *Ting*, 2003 WL 292296, at *20-22 & n.15. But the use of the unconscionability doctrine to amend arbitration agreements to authorize class actions where the parties have not done so is not arbitration-neutral. To the contrary, it reflects a state policy mandating a particular type of arbitration procedure *notwithstanding* the contracting parties' wishes. The FAA does not allow States to regulate arbitration in this manner, regardless of whether they purport to impose such regulation through the rubric of a general doctrine like unconscionability. *See, e.g., Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687-88 (1996) (FAA preempts state law requiring notice of arbitration clause in underlined capital letters on first page of contract); *Mastrobuono*, 514 U.S. at 58 ("[I]f contracting parties agree to include claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms *even if a rule of state law would otherwise exclude such claims from arbitration*.") (emphasis modified). What matters is not the legal *label* placed on the state law or policy, but whether that law or policy is specific to arbitration. Were the law otherwise, States would be free to thwart arbitration at will by simply invalidating any disfavored arbitration provision as unconscionable.

Indeed, allowing States to rewrite arbitration agreements in this manner would allow States to undermine arbitration itself. The whole point of arbitration is to "trade[] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi Motors*

Corp. v. Soler Chryler-Plymouth, Inc., 473 U.S. 614, 628 (1985). That trade-off is attractive not just to large corporate defendants, but to plaintiffs as well: "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind. *See* S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924) (the Act, by avoiding 'the delay and expense of litigation,' will appeal 'to big business and little business alike, . . . corporate interests [and] . . . individuals.'" *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995). That trade-off breaks down, however, to the extent that arbitration proceedings start to mimic the complexity of courtroom proceedings. *See, e.g., Keating*, 31 Cal. 3d at 623 (Richardson, J., concurring and dissenting) ("[C]lass procedures would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal."). Parties forced into involuntary classwide arbitration thus get the *worst* of both worlds: the complexity and delay of class-action litigation, without the accompanying procedural safeguards and meaningful appellate review. Parties may be willing to bear the risk of arbitrator error in an individual case, assuming that over time errors favoring one side or the other will neutralize each other in the aggregate, but the impact of an error in a class arbitration is multiplied by the number of class members.

Because a state policy mandating classwide arbitration absent an express agreement to that effect "would disrupt the negotiated risk/benefit allocation and direct the parties to proceed with a different sort of arbitration" than they had bargained for, *Champ*, 55 F.3d at 275 (internal quotation and brackets omitted), the FAA preempts such a policy.

II. INTERPRETING THE FAA TO AUTHORIZE CLASSWIDE ARBITRATION ABSENT AN EXPRESS AGREEMENT WOULD RAISE SERIOUS CONSTITUTIONAL QUESTIONS.

The conclusion that the FAA does not allow the States to mandate classwide arbitration absent an express agreement follows not just from the text of the FAA itself, but also from underlying constitutional concerns. Class actions are a "recognized exception" to the "principle of general application in Anglo-American jurisprudence that one is not bound by a judgment in personam in a litigation in which he is not designated as a party or to which he has not been made a party by service of process." *Hansberry v. Lee*, 311 U.S. 32, 40-41 (1940); *see also General Tel. Co. v. Falcon*, 457 U.S. 147, 155 (1982) ("The class-action device was designed as an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.") (internal quotation omitted). Because the class-action device raises serious due process concerns, *both* with respect to the party forced to litigate against the class *and* with respect to absent class members, the Federal Rules of Civil Procedure and analogous state procedural rules have been carefully construed to ensure "minimal procedural due process protection" in class actions. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811-12 (1985).

The procedural protections of these rules, however, do not apply in arbitration absent an explicit agreement of the parties. *See Pike v. Freeman*, 266 F.3d 78, 92 n.17 (2d Cir. 2001) ("Federal Rules of Civil Procedure do not apply in arbitrations before the American Arbitration Association."); Cal. Civ. Proc. § 1282.2(d) ("rules of judicial procedure need not be observed" in an arbitration); *Schlessinger v. Rosenfeld, Meyer & Susman*, 40 Cal. App. 4th 1096, 1108 (2d Dist. 1995) (same). Thus, there is no structural mechanism in arbitration to protect the unique due process concerns presented by class actions. That is not a problem with arbitration, which is a vital tool for dispute resolution; rather,

it is a problem with engrafting class action procedures onto arbitration agreements absent the parties' express consent. To be sure, parties *can* agree to waive their due process rights by agreeing to arbitration. But there is no reason for courts to presume that they *have* done so; to the contrary, the serious due process implications of class actions warrant construing the FAA not to authorize classwide arbitration absent the express agreement of the parties. It is elementary that courts should construe statutes to avoid, rather than precipitate, constitutional questions. *See, e.g., Jones v. United States*, 529 U.S. 848, 857-58 (2000); *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988).

The foregoing due process concerns are only heightened by the lack of effective judicial review of arbitration awards. Such review is sharply circumscribed for the very purpose of preserving the efficiency and finality characteristic of arbitration. *See, e.g., Moncharsh v. Heily & Blase*, 3 Cal. 4th 1, 10 (1992). While the precise rules vary by jurisdiction, arbitration awards are generally difficult to overturn even for clear error. In California, even an unjust award is not subject to review: "an arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties." *Id.* at 6.

In the federal system, the FAA supplies the standards for judicial review of arbitral awards. An award may be vacated or modified where procured by corruption, fraud, or undue means; where there was evident partiality or corruption in the arbitrators; where the arbitrators improperly refused to hear material evidence or postpone the hearing; where the arbitrators exceeded their powers; or where there was an evident miscalculation or mistake. 9 U.S.C. §§ 10, 11. The Ninth Circuit has described such review as "extremely narrow . . . If, on its face, the award represents a plausible interpretation of the contract, judicial inquiry ceases and the award must be enforced." *Sovak v. Chugai Pharm. Co.*, 280

F.3d 1266, 1271 (9th Cir. 2002) (citations omitted); *see also Lapine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884, 888 (9th Cir. 1997) ("[A] federal court may vacate or modify an arbitration award only if that award is 'completely irrational,' exhibits a 'manifest disregard of law,' or otherwise falls into one of the grounds set forth in 9 U.S.C. §§ 10 or 11.") (internal quotation omitted).

In a classwide arbitration, these deferential standards of review could easily lead courts to uphold plainly incorrect and unjust decisions. Indeed, in this very case, the South Carolina Supreme Court refused to modify its standards of review or subject to serious scrutiny the arbitrators' $27 million award to 3,700 class members. *See Bazzle v. Green Tree Fin. Corp.*, 351 S.C. 244, 266-67 (2002) (upholding award where no showing of "manifest disregard for the law" and noting that while the standard for appellate review of a court's class certification decision is abuse of discretion, the review of an arbitral award is "far more limited."); *see also Discover Bank v. Boehr*, 105 Cal. App. 4th 326, 348 (2d Dist. 2003) ("[A] multi-million dollar class arbitration award entered on nothing more than mere whim cannot be corrected under California law."). It goes without saying that an error in a classwide arbitration proceeding is far more prejudicial to the defendant than an error in an ordinary individual arbitration proceeding. Defendants should not be forced to defend against classwide claims in arbitration where they have not agreed to do so, and forcing defendants to do so would violate the due process rights of both defendants themselves and the absent class members.

The due process risks of class arbitrations cannot be solved by simply engrafting "due process" judicial oversight onto the established deferential procedures. More fundamental changes would be necessary. Arbitrators need not preserve a transcript of their proceedings or justify their awards with written opinions. *See, e.g., Bernhard v. Polygraphic Co. of Am.*, 350 U.S. 198, 203-04 & n.4 (1956). The potential absence of any record for review

complicates still further the protection of constitutional due process rights. It is apparent that even to begin to ensure due process, courts would need to radically change their arbitration review standards and require arbitrators to preserve records of arbitrations—requirements that will undercut the benefits of arbitration agreements long recognized and protected by this Court. Absent the agreement of the parties, changes of this magnitude should be accomplished only by legislation, not judicial fiat.

To be sure, the due process risk could be minimized if a court retained control of all class action procedures, but only at the expense of the efficiency, cost, and finality that arbitration was supposed to provide in the first place. Thus, academic proposals for courts to assume a greater role in overseeing arbitration class actions are infeasible.[3] In effect, such proposals would create a hybrid judicial-arbitral proceeding, where the parties litigate class issues and arbitrate merits issues—a cumbersome and inefficient procedure at best that derogates the parties' agreement to arbitrate all disputed issues. Presumably, courts in this scenario would be called upon to undertake on ongoing supervisory role over an arbitration, to ensure that a class certification decision is appropriate not just as an initial matter, but on a continuing basis. *See* Fed. R. Civ. P. 23(c)(1); *Boucher v. Syracuse Univ.*, 164 F.3d 113, 118 (2d Cir. 1999).

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[3] *See, e.g.*, Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, will the Class Action Survive?*, 42 Wm. & Mary L. Rev. 1, 111 (2000) ("Allowing arbitrators on their own to decide [due process issues] simply will not comport with the Due Process Clause."); Daniel R. Waltchter, *Classwide arbitration and 10B-5 Claims in the wake of Shearson/American Express, Inc. v. McMahon*, 74 Cornell L. Rev. 380, 402 (1989) ("In spite of the fact that courts traditionally hesitate to intervene in an arbitral forum, judicial discretion must exist in the classwide arbitration setting if courts are to protect the absent class members' due process rights.").

Amicus DIRECTV knows the downside of such a hybrid proceeding from firsthand experience. In Oklahoma, a state trial court asserted control over the class certification process, imposed a four-month discovery schedule to be followed by a two-day class certification hearing, and effectively suspended the arbitration in the meanwhile. Besides the mere length and expense of the certification litigation, such proceedings often require discovery that goes beyond that allowed under the applicable arbitration rules. Thus, the plaintiffs in the Oklahoma DIRECTV action propounded numerous interrogatories ostensibly seeking "class" discovery—even though the commercial rules of the American Arbitration Association do not permit interrogatories (or depositions) absent agreement of the parties. *See Commercial Rules of Am. Arb. Assoc. (2003)*, R-23 (allowing for exchange of documents only). Yet the avoidance of costly or abusive discovery is often a reason why parties enter into arbitration agreements in the first place. *See Hires Parts Serv. v. NCR Corp.*, 859 F. Supp. 349, 353 (N.D. Ind. 1994). Accordingly, any suggestion that a hybrid court-arbitration proceeding might provide a workable mechanism to "cure" the due process problems with classwide arbitration is illusory.

CONCLUSION

For the foregoing reasons, the judgment of the South Carolina Supreme Court should be reversed.

Respectfully submitted,

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